MOTION FILED
MAR 17 2003

(4)

No. 02-1196

In The Supreme Court of the United States

SECURITIES AND EXCHANGE COMMISSION, PETITIONER
v.
CHARLES E. EDWARDS, RESPONDENT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE*
and
BRIEF *AMICI CURIAE* IN SUPPORT OF PETITIONER

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30 pp

AMICI CURIAE

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SECURITIES AND EXCHANGE COMMISSION,
PETITIONER
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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE* IN SUPPORT OF PETITIONER[1]

The *Amici Curiae*, the State of Florida Department of Financial Services Office of Financial Institutions and Securities Regulation, the State of

[1] No counsel for a party authored this petition in whole or in part, and no person or entity other than *amici curiae* made a monetary contribution to the preparation or submission of this petition.

Alabama Securities Commission, and the State of Colorado Department of Regulatory Agencies Division of Securities ("*Amici Curiae*"), through undersigned counsel, respectfully move this Court, pursuant to Rule 37.2(b) of the Rules of the Supreme Court, for leave to file the accompanying brief *amici curiae* in support of the Petitioner, the Securities and Exchange Commission.

The Petitioner has granted its permission for the *Amici Curiae* to file the accompanying brief; however, the Respondent declined, via telephone, to grant its permission.

The *Amici Curiae* are extremely concerned with the judgment issued by the United States Court of Appeals for the Eleventh Circuit in this case, and take this opportunity to extend their support to the Securities and Exchange Commission ("SEC" or "Commission") in its petition for certiorari. The Eleventh Circuit's interpretation of the definition of an "investment contract," as set forth in its judgment, not only varies from previous interpretations of the definition but, if allowed to stand, establishes a significant loophole for unscrupulous investment promoters to devise programs that will avoid regulation by the SEC and, in large part, the states which have frequently passed legislation to mirror federal law and federal interpretation of an investment contract. The *Amici Curiae* submit this brief to bring to the Court's attention the importance of the decision below and its potential to severely hinder their efforts to protect the investing public from fraudulent or questionable investment schemes.

The Eleventh Circuit's decision conflicts with existing federal and case law and, thus, adds confusion to the complex arena of securities regulation for both the SEC and the states.

For the foregoing reasons, the *Amici Curiae* move this Court for leave to file the accompanying brief *amici curiae* in support of Petitioner.

Respectfully Submitted,

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I

QUESTION PRESENTED

Whether the court of appeals erred in dismissing the complaint on the ground that an investment scheme is excluded from the term "investment contract" in the definitions of "security" in Section 2(a)(1) of the Securities Act of 1933, 15 U.S.C. 77b(1)(1), and Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10), if the promoter promises a fixed rather than variable return or if the investor is contractually entitled to a particular amount or rate of return.

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INTERESTS OF *AMICI CURIAE*

The interests of the *Amici Curiae* are set forth in the foregoing Motion of The *Amici Curiae* for Leave to File Brief *Amici Curiae* in Support of Petitioner.

SUMMARY OF ARGUMENT

The regulation of the investment, or securities, industry began with the states which independently developed a broad base of statutory and case law designed to protect the public from unscrupulous investment promoters. These laws became known as "Blue Sky Laws" in recognition of their attempt to protect investors from participating in investments that were of no more "real value" than owning a piece of the sky. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed.1244 (1946)

As our nation matured and investment opportunities and schemes proliferated, Congress, in the wake of the 1929 stock market crash, passed the Securities Act of 1933 and, shortly thereafter, the Securities Exchange Act of 1934 (the "Acts"). These laws, designed to oversee and regulate the securities industry on a national level, supplemented and complimented the existing state system of blue sky laws. The net effect was a regulatory system that protects both the national securities markets, overseen by the Securities and Exchange Commission ("SEC"), and the more centralized, local securities markets, regulated by each state individually.

When faced with interpreting the "new" Acts, this Court, in recognition of the strength and wisdom of the states' experience, turned to the state court decisions,

and used those decisions as a springboard for developing the federal law. Recognizing the benefit of establishing consistency in the regulation of securities, the states began to look to the developing federal law for guidance in interpreting and applying their state laws. In so doing the state and federal systems developed bodies of case law which, in large part, unite to provide a strong regulatory base for protecting the investing public. However, as with most things regulated, investment promoters developed investment products which did not fit neatly into the investment categories defined by statute.

The Eleventh Circuit's decision in this case is an inadequate judicial response to a promoter's investment scheme. While the states will continue to regulate the securities industry on their local levels and the SEC will continue to regulate the industry on a national level, the effectiveness of the interlocking systems will be lessened without the benefit of this Court's wisdom and guidance.

I. The Eleventh Circuit's decision narrowed the *Howey* test

In applying the *Howey* test, the Eleventh Circuit relied upon a restatement of the test which omitted crucial language that appeared in *SEC v. W.J. Howey Co.*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed.1244 (1946). When this Court issued its decision in *Howey*, it adopted an existing definition of "investment contract" the Minnesota Supreme Court articulated in *State v. Gopher Tire & Rubber Co.*, 177 N.W. 937 (Minn. 1920): "[a]n investment contract thus came to mean a contract or scheme for 'the placing of capital or laying out of money in a way intended to secure income or profit from its employment." *Id.* at 1102. When this Court applied

the existing definition of "investment contract" to the facts of *Howey* it referred to the investment as returning "profit" to the investor, but did not mention the word "income." In relying on the *Howey* decision, the Eleventh Circuit turned to the streamlined language rather than the original definition. In so doing, the Eleventh Circuit eliminated the concept of income and focused on "net profit" - a concept which was not adopted by this Court in *Howey*.

II. Speculative Versus Non-speculative Investments

This Court in *Howey* specifically stated that, in determining whether an investment product meets the definition of an "investment contract," it is immaterial whether the investment product was speculative or non-speculative and whether the investment involved an asset of intrinsic value. However, the Eleventh Circuit repeated the same mistake as the Fifth Circuit Court of Appeals made 56 years earlier in *Securities & Exchange Commission v. Howey*, 151 F.2d 714 (5th Cir. 1945). In the case at bar, the Eleventh Circuit ignored this Court's determination that the speculative nature of the investment was immaterial when determining whether an investment product fitted within the definition of an "investment contract." The eleventh Circuit mistakenly injected "risk" and the speculative nature of the investment as the determining characteristic of jurisdiction.

III. Form Over Substance

By concentrating its analysis on the sale-leaseback agreements entered into between ETS and the investors, the Eleventh Circuit elevated form over substance. The Eleventh Circuit mistakenly allowed the

lease agreement, which purported to provide a fixed monthly return and a guaranteed "re"-purchase price for the payphone, to inoculate the entire transaction from be an "investment contract." In so doing, the Eleventh Circuit ignored that the lease agreement and its promises to pay and to repurchase were merely false promises within a larger scheme of false promises designed to dupe investors. *See generally, Dassero v. Edwards*, 190 F.Supp.2d 544 (W.D.N.Y. 2002); *State v. Justin*, 237 F.Supp.2d 368 (W.D.N.Y. 2002); *Hornor, Townsend & Kent, Inc. v. Hamilton*, 218 F.Supp.2d 1369 (N.D.Ga. 2002) (each case provides a brief discussion of the ETS Payphone, Inc. Investment program)

ARGUMENT

I. The Eleventh Circuit's decision narrowed the *Howey* test

The Securities Act of 1933 and the Securities Exchange Act of 1934 (the "Acts") are remedial legislation passed by Congress to protect investors from unscrupulous investment promoters and as such require broad and liberal construction. *El Khadem v. Equity Securities Corp.*, 494 F.2d 1224 (9th Cir. 1974) citing *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946); *Techerepnin v. Knight*, 389 U.S. 332, 336, 88 S.Ct. 548, 19 L.Ed.2d 564 (1967). In passing the Acts, Congress joined the states in their efforts to protect the investing public from fraudulent investment programs. As this Court said in *United Housing Foundation v. Forman*, 421 U.S. 837, 95 S.Ct. 2051, 44 L.Ed.2d 621 (1975),

> The primary purpose of the Securities Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto.

Id. at 849, 95 S.Ct. at 2059, 44 L.Ed.2d at 630.[1] While the federal securities laws were enacted with a focus toward the broad purpose of protecting the national securities market, the individual states' securities laws had a more localized focus.

As the federal body of law developed through the interpretation and application of the Acts, the state law concept of an "investment contract" was adopted and articulated in the federal courts. The states had long ago established a framework for determining whether a

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[1] As the Court of Appeals in *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252 , n. 1, (9th Cir. 1976), "The 'capital market' referred to by the Court includes debt as well as equity instruments". *See Investment Company Institute v. Camp*, 401 U.S. 617, 635, 91 S.Ct. 1091, 1101, 28 L.Ed.2d 360, 380 (1971), quoted infra note 2 of concurring opinion.

transaction qualified as an investment contract. *See, Gopher Tire & Rubber Co.*, 177 N.W. at 938. That framework was adopted and succinctly formalized by the United States Supreme Court in *Howey*. While embracing the states' analysis of what constitutes an "investment contract," the lower federal courts have glossed *Howey* into a three-prong test:

1. An investment of money;
2. The existence of a common enterprise; and
3. An expectation of profits to be derived solely from the efforts of another.

The abbreviated language utilized by the lower courts in the *Howey* test has, over time, become ingrained in federal and state case law.[2] However, the Court's actual words in *Howey* reveal that the concise, three-prong test omitted what becomes critical language in ETS and similar scenarios. The *Howey* Court acknowledged, and preserved, the Minnesota Supreme Court's definition of an "investment contract" stating:

> The term 'investment contract' is undefined by the Securities Act or by relevant legislative reports. But the term was common in many state 'blue sky' laws in existence prior to the adoption of the federal statute and, although the term was

[2] *Brown v. Rairigh*, 363 So.2d 590 (Fla. 4th DCA, 1978); *See also, Payable Accounting Corporation v. McKinley*, 667 P.2d 15 (Utah 1983); *Sauer v. Hays*, 539 P. 2d 1343 (Colo. Ct. App. 1975); *Ex parte State of Alabama* (Re: *Burke v. State)*, 385 So. 2d 648 (Ala. 1980).

> also undefined in state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection. Form was disregarded for substance and emphasis was placed upon economic reality. An investment contract thus came to mean a contract or scheme for 'the placing of capital or laying out of money in a way intended to *secure income* or profit for its employment.' *Gopher Tire & Rubber Co.*, supra at 938.

Howey, 328 U.S. at 298, 66 S.Ct. 1102 (emphasis added). Although *Howey* is viewed as the quintessential authority on what constitutes an investment contract, the Supreme Court itself acknowledged that it was simply borrowing a concept and definition already established through state blue sky cases and applying it to the specific facts in *Howey*. As shown above, and adopted by this Court, the state definition of "investment contract" included the anticipated receipt of "income *or* profit." *Id.* (Emphasis added.) This adoption is critical for understanding *Howey*, because the terms "income" and "profit" are not always synonymous. Rather, "income" is defined as "money, etc. received in a given period, as wages, rent, interest, etc." where "profit" is defined as "financial gain; esp. the sum remaining after deducting costs." *Webster's New World Dictionary* (1990). In other words, "income" is a broader concept than "profit." "Income" encompasses the receipt of revenue. *All* revenue qualifies as income. Whereas, "profit" usually represents a value remaining after some portion, or all, expenses have been deducted from the revenue received. In mathematical terms,

"profit" can be described as a subset of "income" - a portion of the revenue received. Regardless, the court did not exclude income, but rather said "income or profit," implying the broadest use of those terms.

This Court spoke solely in terms of "profit" only in *Howey* because, as a review of the facts of that case reveals, *Howey* involved an investment plan which offered the investors a share of the *profits* realized from the sale of the fruit as opposed to a stream of "income," as was the case in ETS. That is, the plan that was marketed in *Howey* expressly provided that the investors would receive a portion of the revenue that was left *after* expenses - or, as the *Howey* court stated "an allocation of the net profits." *Howey*, 328 U.S. at 298, 66 S.Ct. at 1102.

Citing to *Forman*, the Eleventh Circuit reasoned:

> In *Forman*, the Court made clear that the word "profits" has a limited meaning under federal securities law. Profits, in that context, require either a participation in earnings by the investor or capital appreciation. *See id.* at 852, 95 S.Ct. 2051 ("By profits, the Court has meant either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors' funds . . . .")

Securities and Exchange Commission v. ETS Payphones, Inc., 300 F.3d 1281, 1284 (11th Cir. 2002). However, the *Forman* court did not state that the "earnings" had to come from the "profits" of the investment program.

Black's Law Dictionary defines "earnings" as income. *Black's Law Dictionary* (5th ed. 1979). "Earnings" can also be described as the income generated by the use of assets. The Eleventh Circuit, however, failed to acknowledge or recognize the common understanding of term "profit," but rather chose to interpret "earnings" and "profit" in the highly technical, economic sense of return on risk in "net" earnings or profit, i.e. the revenue remaining after expenses are deducted. Of course, under the Eleventh Circuit's interpretation, the monthly payments to the investors would be a cost of operation to ETS. Mistakenly, the Eleventh Circuit applied the narrowest possible interpretation to the terms "profits" and "earnings," i.e. "net" earnings or "net" profits.

Under *Howey*, the ETS investors were, indeed, participating in the "profits" or "earnings" of the investment program since the lease payments could only be made if ETS's ponzi scheme continued with the sale of pay phones. Even if there were no ponzi scheme, ETS's ability to make the lease payments was dependent on the success of ETS's generating income through the management and placement of the pay telephones.

Further, the Eleventh Circuit's mistakenly restrictive interpretation imports a foreign risk-based analysis into the law and flies in the face of the well settled concept that legislation is to be construed so as to give meaning to the legislative policy behind it. This Court, in *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 64 S.Ct. 120, 88 L.Ed. 88 (1943), taught:

> Some rules of statutory construction come down to us from sources that were hostile toward the legislative process itself and thought it generally wise to restrict the operation of an act to its

> narrowest permissible compass. However well these rules may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy.

Id. at 350, 64 S.Ct. at 123 (footnotes omitted). *See also, El Khadem*, 494 F.2d at 1227 (9th Cir. 1974).

The Eleventh Circuit mistakenly held that the fixed income feature of the ETS program prevented the sale and leaseback of the pay phones from being classified as a security because the investors had no expectation of receiving "profits" derived solely through the efforts of others but, rather were entitled to a risk-free fixed return, or income, guaranteed by contract. The Eleventh Circuit relied on a narrow gloss of an "investment contract" and failed to consider the actual text of the definition, as set forth in *Howey*. *Howey* adopted Minnesota's inclusive language in referring to "the placing of capital or laying out of money in a way intended to *secure income* or profit." *Howey*, 328 U.S. at 298, 66 S.Ct. at 1102 (emphasis added).

This Supreme Court's position that an "investment contract" could include an investment with a payoff that is stable is further illustrated by this Court's response to the Appellate Court's reasoning in *Securities & Exchange Commission v. Howey*, 151 F.2d 714 (5th Cir. 1945), where this Court stated:

> We reject the suggestion of the Circuit Court of Appeals, 151 F.2d at 717, that an investment contract is necessarily missing where the enterprise is not speculative or promotional in character and where the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole. The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, *it is immaterial whether the enterprise is speculative or non-speculative* or whether there is a sale of property with or without intrinsic value.

Howey, 328 U.S. at 301, 66 S.Ct. at 1104 (emphasis added). In 1946, this Court rejected the same narrow risk-based analysis that the Eleventh Circuit adopted in its 2002 ETS decision 56 years later.

II. Speculative Versus Non-speculative Investments

"Speculative," in the common use of the word, refers to any risky venture (as buying or selling certain stocks, etc.) with the chance of making huge profits. *Webster's New World Dictionary* (1990). A *non-*speculative enterprise, then, would encompass a venture which is not risky and does not, necessarily, hold the promise of huge profits.

As the Supreme Court of Utah noted in *Payable Accounting*, quoting from *El Khadem*:

> It is true that unlike the situation in *Howey*, the financial gain for Ms. El Khadem did not very

> from year to year depending on the skill with which Nationwide managed her collateral. Rather, only the risk of loss varied with Nationwide's management skills. But this distinction . . . is without significance . . .. The distinction is precisely that between a common stock and a corporate bond, yet a corporate bond is not for that reason excluded from the definition of a security.

Payable Accounting, 667 P.2d at 19, quoting *El Khadem*, 494 F.2d at 1229. *See also, SEC v. Infinity Group Co.*, 212 F.3d 180, 191 (3rd Cir. 2000) ("[T]he investors' beads were strung upon the gossamer guarantee of seemingly impossibly high returns at no risk. The fact that TIGC promised a "fixed rate of return" based upon the amount invested is irrelevant."); *Becks v. Emery-Richardson, Inc.*, 1990 WL 303548 (S.D. Fla. 1990) ("offer of a fixed monthly return and promotion of a tax benefit constituted at least a promise of financial gain or 'profit' resulting solely from the efforts of others.")

In stark contrast, the Eleventh Circuit ignored the *Howey* concept of "income or profit," instead utilizing a wholly inappropriate standard for profit, equating it to a risk-based, "speculative" return on capital. The Eleventh Circuit ignored this Court's fundamental teachings that any return, speculative or non-speculative, "income or profit," in an enterprise is sufficient to satisfy the *Howey* test. Clearly, an investment which provides for a fixed monthly payment, even one "guaranteed" by the promoter's contract with the illusory right to sue, qualifies as an investment contract.

III. Form Over Substance

As the Utah Supreme Court said in *Payable Accounting Corporation*, quoting *LTV Federal Credit Union v. UMIC Government Securities, Inc.*, 523 F. Supp. 819, 829, n. 5 (N.D. Tex. 1981), "[t]he crucial factor is not whether the rate of return is fixed, but whether the 'investment transaction is so structured that the money to pay off the investor eventually will be generated by the venture or enterprise'." *Payable Accounting Corporation*, 667 P.2d at 19.

In *People v. Milne*, 690 P.2d 829 (Colo. 1984), the Colorado Supreme Court was faced with an investment scheme involving "investment notes" which provided for a quarterly fixed-rate interest payment and a five-year maturity date along with a provision permitting the investors to accelerate the maturity date with 60 days written notice. Utilizing the *Howey* test to determine that an investment contract was involved, the Colorado Supreme Court reasoned:

> The [investment note] holders invested with the primary purpose of receiving profits.
>
> The holders also invested in a "common enterprise" insofar as *the return on their money paid to VLA was dependent upon the continuing operation and success of the business. Should the corporation become insolvent or sustain substantial financial losses, as was the case, the source of the fund from which payment was to be made would be lost.* Moreover, the investors' expectation of profit derived solely from the managerial efforts of others. Payment of the promised return

> depended solely upon the ability of the defendant and other VLA officials to successfully manage and operate the corporation. The investors had no ability to control or manage the funds they invested or otherwise ensure that their promised return was actually paid.

Milne, 690 P.2d at 833 (citation omitted; emphasis added).

This truth was implicitly admitted by ETS in its bankruptcy case wherein ETS pled, in a declaratory judgment class action, that the lease agreements between ETS and the investors *were not properly characterized as "true leases"* and, therefore did not give the investors a security interest in the pay phones:

> The Class member [investors] paid, directly or indirectly, for public payphones by entering into form sale-leaseback agreements with Debtors [ETS] (the "Agreements"). A true and complete copy of a representative Agreement is attached hereto as Exhibit A. Pursuant to the Agreements, Debtors maintained possession of the phones and managed and operated the phones on behalf of the members of the Class. The Class members retained little, if any, control over the payphones. The Class members did not participate in the operation of the payphones. Debtors paid the Class a stream of income in monthly installments.

Second Amended Complaint For Declaratory Judgment, in *In Re PSA, Inc., a Delaware corporation, and Affiliates, Debtors; PSA, Inc, and ETS Payphones, Inc. v. Stow*, in the United States Bankruptcy Court for the District of Delaware, case no. 00-3570 (EIK), Adversary Proceeding No. A-01-4711, p. 4, ¶ 9. The net result of ETS's bankruptcy pleading was to characterize the investors as unsecured creditors, enabling ETS to "claim" the pay phones as assets. By claiming the pay phones as assets, ETS was, in effect, "given" significant assets to be used by the reorganized company in which *the pay phone investors were given stock. See, First Amended Joint Reorganization Plan Submitted by the Debtors and the Official Committee of Unsecured Creditors, In Re: PSA, Inc., ETS Payphones Inc., ETS Vending, Inc., Et Al.*, United States Bankruptcy Court for the District of Delaware, Case No. 00-3570 (JCA).[3]

As this Court acknowledged in *Techerepnin*, 389 U.S. at 336, 88 S.Ct. at 553 (1967), "form should be disregarded for substance and the emphasis should be on economic reality." For the Eleventh Circuit form was paramount. Simply because a lease with ostensibly fixed payment was given to investors, the Court ignored the evidence of record that ETS could not generate funds absent the ponzi scheme sale of more telephones, could not repurchase the telephone, and could not in

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[3] A copy of this document is set forth in the *Lodging of Amici Curiae* as an attachment to the *Findings of Fact, Conclusions of Law and Order Confirming The Joint Reorganization Plan Of PSA, Inc., ETS Payphones, Inc. And ETS Vending, Inc., Et Al.*, in the case of *In Re: PSA, Inc., ETS Payphones, Inc., ETS Vending, Inc. Et Al.*, in the United States Bankruptcy Court for the District of Delaware, Case No. 00-3570.

reality make the lease payment. In substance the lease was an empty promise and merely another fraudulent misrepresentation to induce investors into purchasing the investment contracts, the pay telephone-management package. The "lease" was as real as the promise made to Florida investors that the investment contract was as safe as an annuity.

In its wisdom, this Court, in *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 689, 105 S.Ct. 2297, 2303, 85 L.Ed.2d. 692 (1985), acknowledged that "*SEC v. W.J. Howey Co., supra*, further elucidated the *Joiner* Court's suggestion that an unusual instrument could be considered a 'security' if the circumstances of the transaction so dictated." In reviewing the ETS investment scenario, the Eleventh Circuit Panel myopically focused on the leaseback agreement between ETS and the investor rather than viewing the transaction as a whole. According to several Florida ETS investors, their investment advisors encouraged them to withdraw funds from more traditional investments, such as annuities, which had been the source of their retirement income and use those funds to buy into the ETS program. The ETS program was marketed not as the sale of a phone to be used by the purchaser but rather as an investment.

The program was described to prospective investors' as offering three (3) management option in which ETS provided a variety of management and maintenance services. Options I and II provided increasing, broad management services for which the investors would pay ETS a monthly fee. Option III, the option to which the investors were directed by the advisor's sales pitch and documents, involved a lease-back agreement which provided that ETS would pay the

investor $984 a year in monthly lease payments in exchange for which "the EQUIPMENT [i.e. pay phone] shall at all times during the Term hereof be under the *sole and absolute control of LESSEE [ETS]*, ..." *Securities & Exchange Commission v. ETS Payphones, Inc., Charles E. Edwards*, in the United States District Court for the Northern District of Georgia, Atlanta Division, Case No. 1:00-CV-2532-JCT.; SEC Exhibit 18, entitled "ETS Payphones, Payphone Equipment Lease Program," pg. 13, paragraph 9 (capitalization in original, italics added).

IV. Certiorari Is Appropriate

As noted by the SEC in its Petition for a Writ of Certiorari and as illustrated above, the Eleventh Circuit's decision in *ETS* is clearly in conflict with concepts and decisions previously ruled upon by this Court. Additionally, the decision conflicts with decisions issued by other federal courts on both the district and circuit levels, as well as conflicting with numerous state court decisions.

The Eleventh Circuit's decision to exclude a contract with a fixed return from the definition of an "investment contract" severely narrows the definition of "investment contract" and creates an environment in which unscrupulous investment promoters can flourish. With very little effort promoters can, and will, structure investment products so as to include a contractual promise of a return and, by doing so, remove themselves from the regulatory jurisdiction of the SEC and, in many cases, its state regulatory counterparts. Clearly, that result is contrary to the legislative policy behind the Acts which were enacted to *protect* the investing public.

The bottom-line effect of the Eleventh Circuit's decision in *ETS* is that investment products which offer contractually guaranteed income to investors along with the promise of the return of the investors' original principal investment do not meet the definition of "investment contract." Obviously, such an outcome flies in the face of logic when viewed in light of Congress's express decision to provide protection under the Acts to individuals who invest in bonds, notes, or even preferred stock - all of which provide for a fixed return in addition to the return of the investors' original investment principal. It is unreasonable to take the position that individuals purchasing investments such as ETS Payphones, Inc. should not be provided the same level of protection afforded their counterparts who invest in bonds, notes, or preferred stock simply because the Eleventh Circuit refused to apply the "investment contract" label to the ETS investment scheme.[4]

The Eleventh Circuit seems to view the existence of the lease-back agreement as a contract which leaves sufficient control in the hands of the investor to exempt the entire investment program from the protections afforded through the Acts. This Court has repeatedly acknowledged that similar investment programs *do* qualify as securities through the application of the *Howey* investment contract concept. Indeed, virtually all investment contracts involve a contract executed by

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[4] The states recognize that bonds and notes are, generally speaking, identified through the use of the "family resemblance" test rather than the *Howey* test; however, this discussion is intended to draw attention to the similarities in the risks assumed by each category of investors.

the parties, thus the name "investment *contract*." The only arguably distinguishing aspect of the ETS investment program is that the contract provides for a fixed monthly return and fixed sale price. This Court has held that the fact that an investment is non-speculative does *not* exclude it from the definition of an investment contract.

This Court stated in *Howey*, as pointed out above, that "it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value." *Howey* 328 U.S. at 301, 66 S.Ct. at 1104.

As the SEC points out in its Petition for a Writ of Certiorari:

> The "investment contract" category has served as a critical means of bringing a host of unconventional financial arrangements - offering both fixed and variable returns - within the purview of the federal securities laws. Excluding such unconventional investments from the scope of the securities laws because they offer a fixed return or are "contractually guaranteed" would be a radical departure from the enforcement history under the Act and would significantly impair the Commission's ability to protect investors from securities fraud.

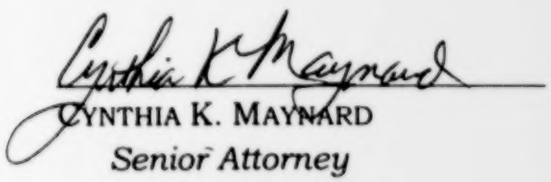
Petition for a Writ of Certiorari, p. 26. As previously noted, the states' securities laws have become entwined with the federal case law. Consequently, just as the Eleventh Circuit's decision, if permitted to stand, would hinder the SEC's effectiveness to protect investors on a national level, the decision will hinder the states' efforts

to protect on the state level.

CONCLUSION

The SEC's petition for a writ of certiorari should be granted.

Respectfully submitted.



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